Water services regulation – some international perspectives

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Some theory and recent history

- South Africa's present policy framework
- established in the 1990s
- Global policy discourse reflected:
  - collapse of the Soviet Union
  - many African economies withering
  - development policy options dictated through *"structural adjustment"* programmes
- Global prescription, "Washington Consensus"

Some theory and recent history

- Public utility privatisation
  - Key element of "Washington Consensus"
- while:-

  "… it matters a lot how privatization is done" …

  either
  - "highly corrupt transfers of assets to privileged" or
  - Benefits, when done properly, and ***is properly regulated***." (Williamson)
- Approach to regulation focused on supporting privatisation, not protecting users from monopoly
- Reflected "industrial policy" of sponsor countries
- Supported by "New Public Management" paradigm

SA's response : follow the leaders

- 1994 democracy born into "unipolar world"
- Little scope for challenge
- Outgoing regime had prepared privatisation
  - (to retain support from erstwhile allies, undoing effective if distorted developmental state….)
- Challenge for delicate negotiated settlement
- Yet 1955 Freedom Charter's nuanced proposal
  - "All other industry and trade shall be controlled to assist the well-being of the people"
- Early recognition of regulation rather than ownership to achieve political objectives ?

International experience: a bumpy road

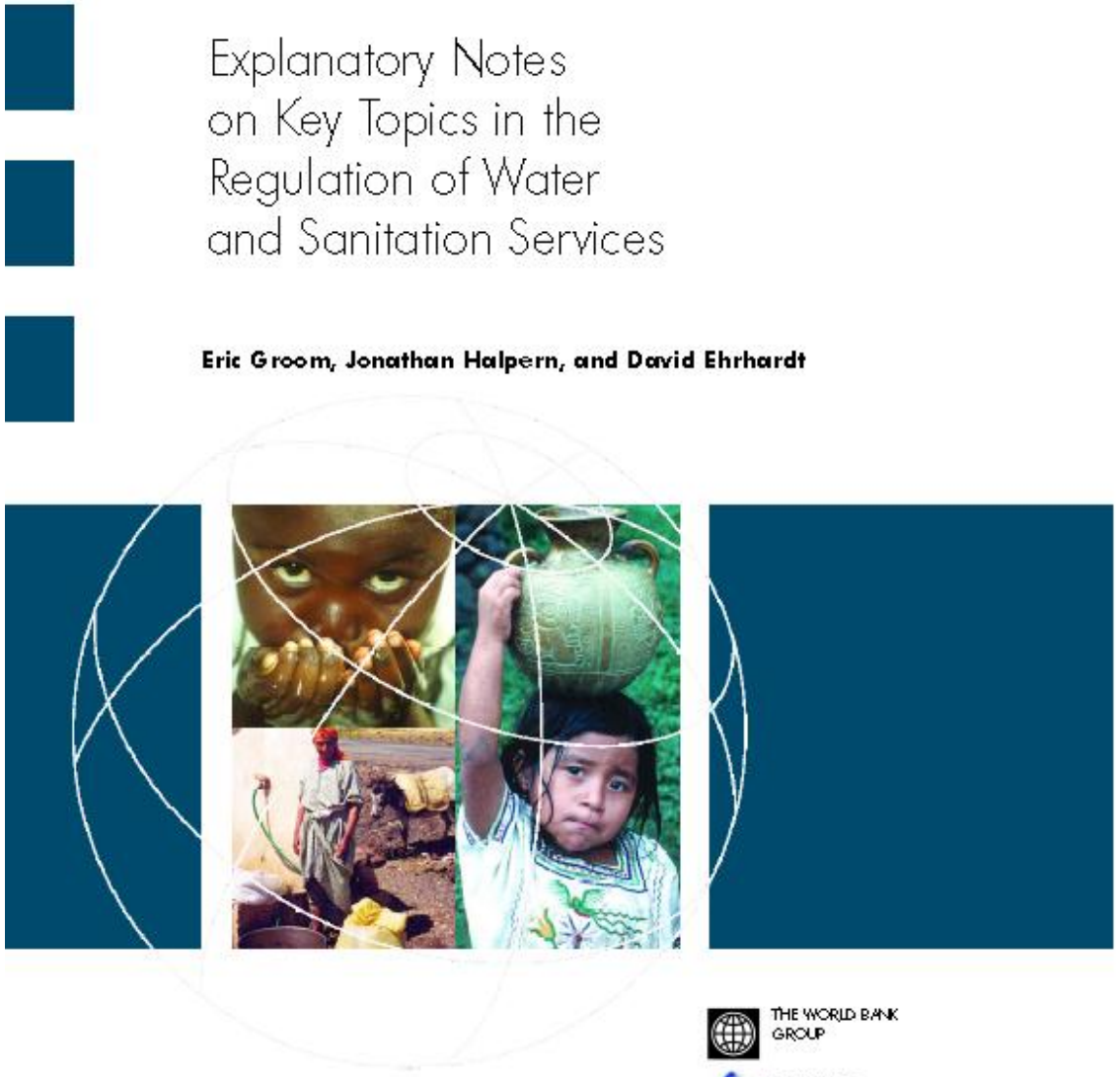
- Current regulation models problematic
- Partly failure of privatisation to achieve goals
  - " there was probably some 'irrational exuberance' in recent years on the potential benefits of privatization".
  - World Bank's Chief Economist
- Failure of regulation contributed to problem:

International experience: a bumpy road

- "… considerable evidence that the expectations of both investors and consumers— the two groups who were supposed to have benefited from these new regulatory systems—often have not been realized for both regulatory decisions and sector outcomes.
- "Investors almost always cite poorly designed and non-credible regulation as one of their biggest disincentives for making new or additional investments.
- " …similar dissatisfaction among consumers…. new regulatory systems have failed either to protect them against the monopoly practices of new private owners of infrastructure facilities or to provide promised improvements and expansion of service.
- "… the two groups to have benefited often believe the opposite: the new regulatory systems have failed to provide either the commitment or the protection they had expected (Handbook for evaluating infrastructure regulatory systems, World Bank, 2006)

Some international experience

learning and focusing on what's needed



Simple, high-level steps to help design economic regulation:

- 1. Define the problems and objectives in the sector.
- 2. Determine whether regulation is well suited to the objectives.
- 3. Define the specific regulatory functions needed to achieve those objectives.
- 4. Decide which legal instruments are best suited to embody the regulatory rules and which organizations are best suited to perform the regulatory functions.

"Although these steps are simple, they are often not followed. Rather, policy makers short-circuit the process, saying, "We know we need regulation, so we had better create a regulator," and importing regulatory designs from elsewhere. The resulting regime may be doubly ill adapted, in the senses that it is not designed to solve the problems the country really has and also that it does not take into account the political, legal, and organizational cultures and capacities in the country."

Water services regulation – some local evidence

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Some empirical results

NEDLAC administered prices study covered:

- Municipal (metro & city) supplies to all users
- DWA and Water Board to large industries
- Performance reasonably good:
  - Industry tariffs up faster than inflation over 2001/7
  - Municipal tariffs for industry up 62% 2001/6
  - Domestic tariffs up 60% (PPIX =30%, CPIX 32%)
  - water board supplies up by 42% over the same period
  - DWAF tariffs varied widely (new pricing strategy)
  - rose 21% (2002/6) cf CPIX rise of 16%

Results – 2

- Prices from all suppliers vary significantly from one location to another reflecting:
  - The water source and specific system requirements;
  - Administrative decisions regarding tariff structures;
  - Operating efficiencies; and
  - Investment in system maintenance and expansion.
- Principle of cost-reflectivity supported
- Above inflation reflecting costs and scarcity?

Results – 3

- Ratio domestic/industrial tariffs
  - indicator of cross-subsidisation from industry
- Varies significantly
  - some, industrial pays top domestic rate
  - Others, at or below average domestic rate
    - cost of industrial supplies less than small users
    - Indicates cross-subsidisation
- Inland cities, high marginal cost of new supplies
- Coastal cities, costs capped by desalination

Results – 4

- South Africa comparable to other countries
  - institutional complexity
  - limited information availability
  - cost of supply to industry
- While real price of water is rising in most countries
  - still often under-priced
  - impacts on longer term reliability and sustainability
- variations in nature and quality of services
  - Malaysia and India, lower costs, lower service quality
  - OECD countries : SA costs 4/11 lowest
  - 5 yr increase amongst the highest.

Conclusions

- "Systemic regulation" must be understood
- Balanced opportunity for engagement
  - Users and Providers
  - In planning and price setting
- Outcomes generally positive
  - National and regional utilities
- Weaknesses
  - Municipal level
  - Challenge not pricing but service management capacity
  - What's needed: "Developmental regulation"
    - Support plus oversight

Conclusions

- Administrative price-setting can work well
- Note need for:-
  - Legislative framework
  - Consultative process
  - Possibility of recourse
- Independent regulators do not assure performance
  - Additional complexity may make decisions difficult
  - Require greater capacity
- Inappropriate in mainly public managed sector
- “Systemic” regulation by user/provider interaction in line with water governance approaches

SA experience? : a bumpy road

- “Although regulators have succeeded in issuing licences, developing pricing methods and establishing technical and service standards, they have not achieved the positive outcomes initially envisaged.

- “Based on the performance of the ICT, electricity and port sectors, South Africa is slipping down international benchmark rankings. The reliability of electricity supply has deteriorated and prices that were previously below economically viable levels are now climbing at rates that consumers are unable to absorb. Communications quality, speed and cost are significantly worse in South Africa than in comparable nations, with a similar situation in rail and port performance.” (National Planning Commission 2012)

South Africa's alternatives

"Regulation works best where there is sufficient political will to support it; where regulators are legally independent, publicly accountable and their decision-making is transparent, and where the regulator is backed by adequate institutional, and human capacity. South Africa faces challenges in all these areas.

"… it makes sense to initially restrain the regulatory agencies' decision-making discretion while their institutional design is reviewed, their roles and accountabilities are clarified and the related legislation and subsidiary regulations are updated."
(NPC 2012)

Must get sector policies and structures right if regulators are going to work well

South Africa's alternatives

- Independent regulators best in stable, mature structures
- Other options:-
  - Internal regulatory administration
  - Regulation by contract
  - Engage users in "collective price regulation"
    - could also inform policy and restructuring
    - address new monopolies, spawn new arrangements, (telecoms cooperative common backbone?)

Countries *can* influence their futures

"The choice of approach to take will depend on the state of the sector and the nature of its challenges. Based on South Africa's practical experience with the use of independent regulators as an instrument to achieve public objectives, the prior challenge is to get the policy right and the sector structures right rather than to establish a particular form of regulator." (NPC 2012)

Countries *can* influence their futures

Not suggesting no benefit from regulation of monopoly network industries

Some independence may help make them more effective

Definition of role of, rules for regulators must be supported by analysis of sector structures and dynamics

Should also consider other options …

Countries *can* influence their futures

- Regulation integral to Washington's privatisation goals
- Current approaches still reflect that agenda
- Not main objective of protecting public interests
- But we are no longer driven by enforced "consensus"
- Moving beyond ideological structural arrangements
- Need 21st century regulation for intended outcomes
- To manage problems of monopolies ….

  … while ensuring efficient equitable services

History may set us on a path
but we can still change course